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Director of
Central
Intelligence

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14 January 1989

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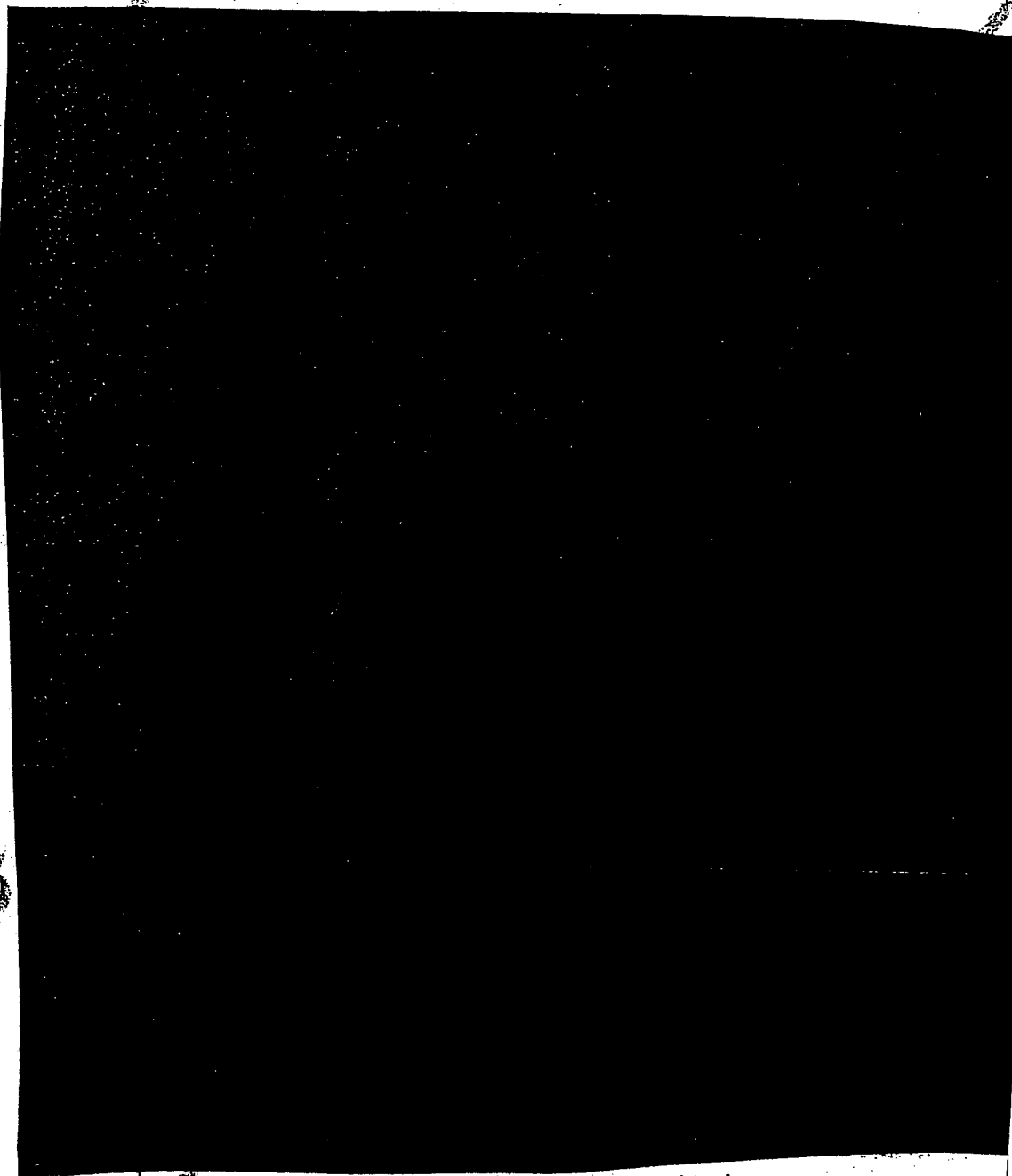
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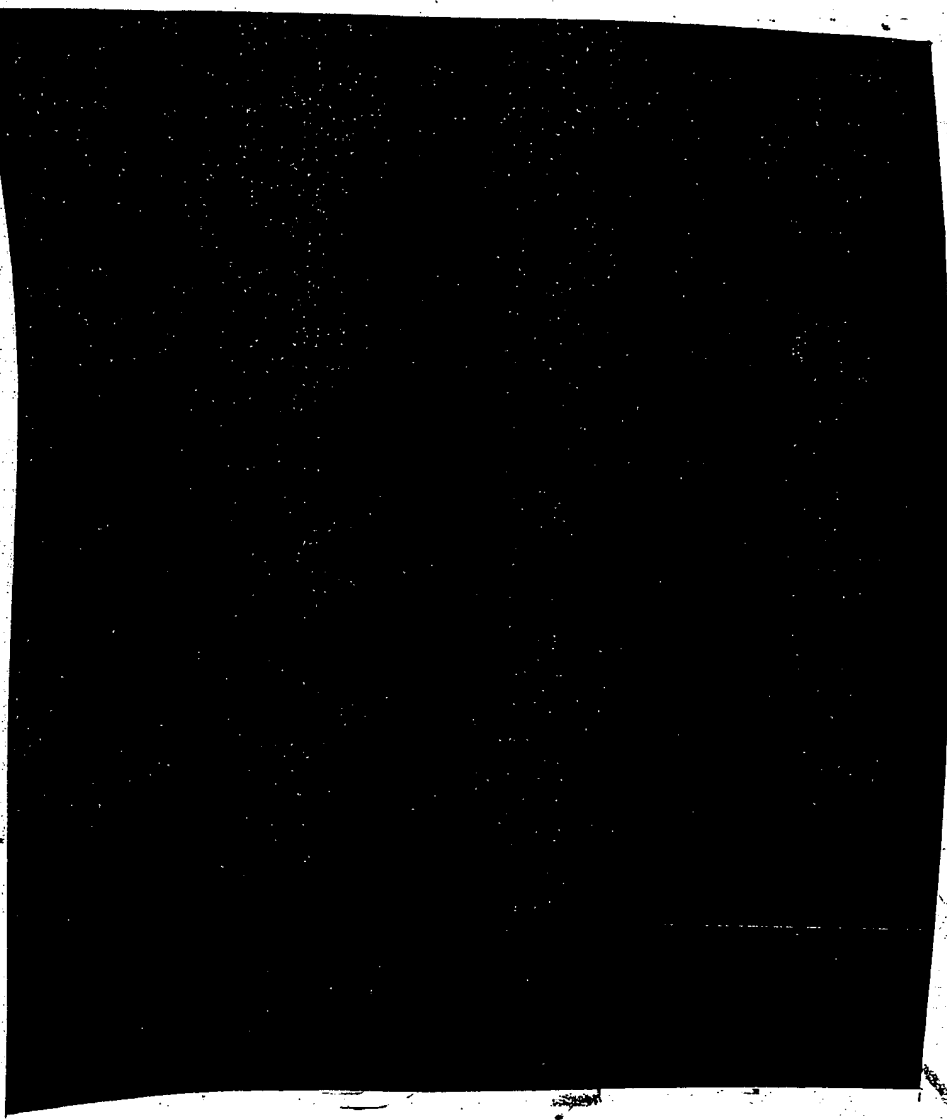
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USSR-
AFGHANISTAN:

Shevardnadze Again Visiting Kabul

Soviet Foreign Minister Shevardnadze's visit to Kabul—he arrived yesterday—probably is intended to coordinate with Afghan President Najibullah the final phase of the Soviet troop withdrawal.

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Shevardnadze went to Kabul a year ago, before Moscow's 8 February statement announcing its plans to withdraw; he was there again in August as the first phase of the withdrawal was nearing completion. Meanwhile, Soviet Deputy Defense Minister Shabanov declared at a press conference in Moscow yesterday that the Soviets would honor their commitment under the Geneva Accords to be out of Afghanistan by 15 February. Shabanov said the second stage of the withdrawal would start soon.

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Shevardnadze's trip probably is also intended to show Moscow's continuing support for its client in Kabul, especially after the failed negotiations with the resistance in Islamabad last week and as Soviet troops withdraw. But, while bucking up regime morale for the hard days ahead, he almost certainly is cautioning Najibullah and the ruling party that factional infighting would threaten the regime's remaining hold on power.

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The Soviets presumably have few illusions about the chances for a favorable political settlement at this late date but, with Kabul, might try one more political gambit to entice the resistance back to the negotiating table or, failing that, to seize the propaganda high ground for the final weeks. In his talks with the Pakistanis and the insurgents last week, First Deputy Foreign Minister Vorontsov showed great interest in the creation of an Afghan consultative council or *shura*—to include "good Muslims" from the regime—as a means to establish a follow-on government. The Soviets and Kabul may offer a list of candidates for such a meeting.

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It is less likely that Moscow and Kabul would announce a government reshuffle that would further diminish the ruling party's presence and rename it, as has been rumored in Kabul, or offer Najibullah's resignation. The resistance has rejected such offers as disingenuous and would do so again. And Moscow and Kabul would almost certainly be concerned that such moves might further damage party unity and morale.

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Shabanov's comments may signal an end to the press blackout the Soviets have been maintaining on their withdrawal activities. Political spokesmen like Vorontsov, however, may continue to threaten nonadherence to the Geneva Accords in last-ditch attempts to push Pakistan and the resistance into a political settlement.

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ALGERIA:

Infusion of Aid Buys Time

Algeria has received more than \$2 billion in grants, concessional loans, and trade credits since the riots in October, giving Algiers a fair chance of muddling through this year without rescheduling its foreign debt.

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says the Kuwait Investment Authority also has delivered a \$100 million grant.

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Among West European creditors, France this week agreed to provide \$1 billion over three years—much of it tied to specific projects—and Italy extended a \$320 million, three-year aid package last month.

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These financial inflows probably will forestall a showdown with international creditors, to whom Algiers owes more than \$5 billion in debt payments this year, but may weaken the government's resolve to press ahead with politically sensitive economic reforms. The aid accord with France and the pending settlement of the longstanding trade dispute over natural gas prices reflect a significant warming of relations.

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AFGHANISTAN: Resistance Sets *Shura* Date

Alliance members have reached agreement to hold their long-postponed *shura* (consultative council) on 1 February. The *shura* is being held to establish a supreme council and a transitional government. The agreement reaffirmed that "good Muslims" from the Kabul regime can be included in the *shura*, but it did not provide any method for involving them. The eight Tehran-based Shia groups have refused to sign the agreement because they were offered only 12 percent of the 480 seats in the *shura*—well below the 25 percent they demanded. An alliance delegation that left for Tehran yesterday will meet with Iranian officials and Afghan Shias to discuss Shia representation in the *shura*.

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Many contentious issues remain to be solved, including where to hold the *shura* and whether former King Zahir Shah is to have a role in the transitional government. Several alliance members had opposed giving the Shias even as many seats as they got and are unlikely to offer them more. Pakistan, which is increasingly concerned about its diminishing influence with the insurgents, will be encouraged that prospects for convening the *shura* are improving, and with them its chances for influence in Afghanistan after the Kabul regime falls.

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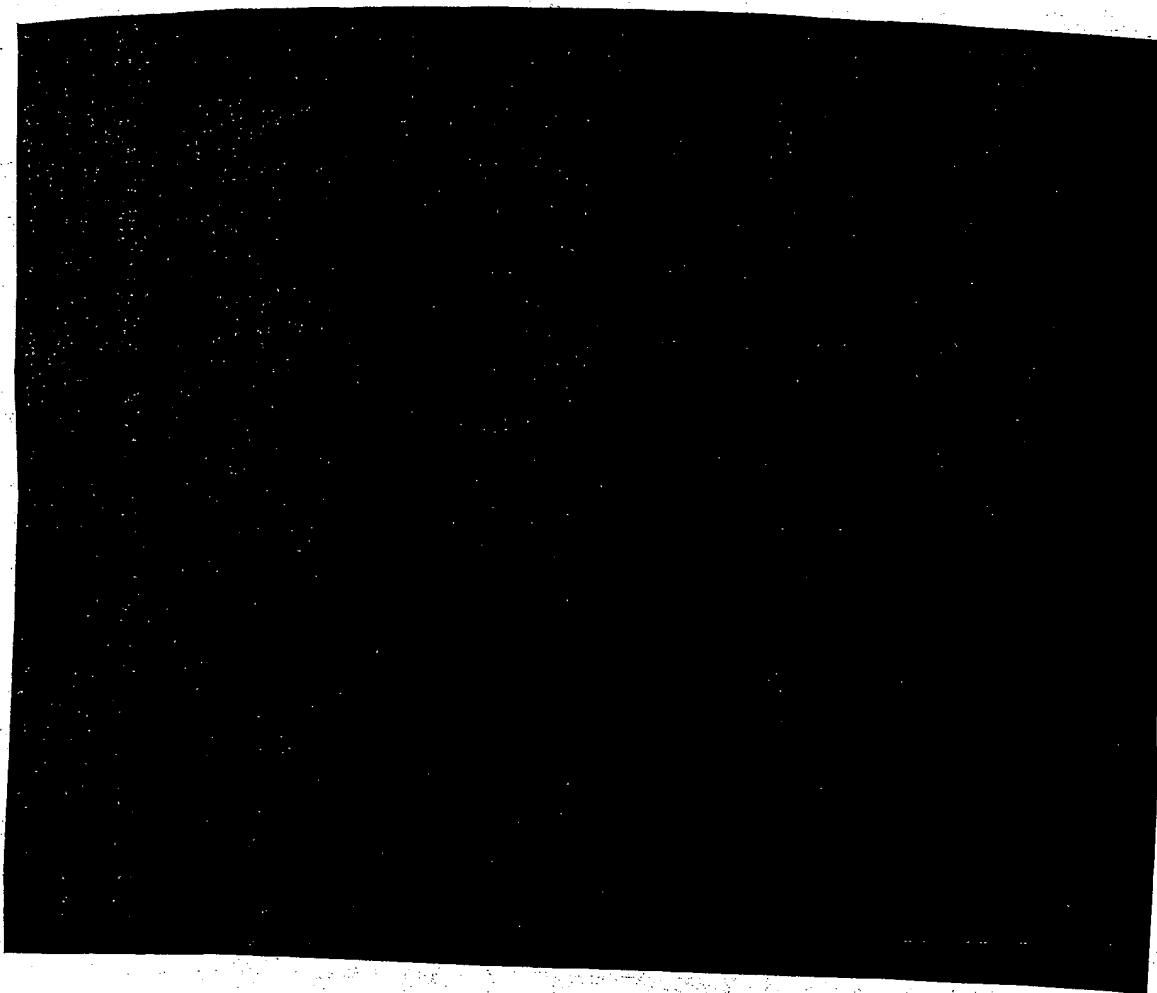
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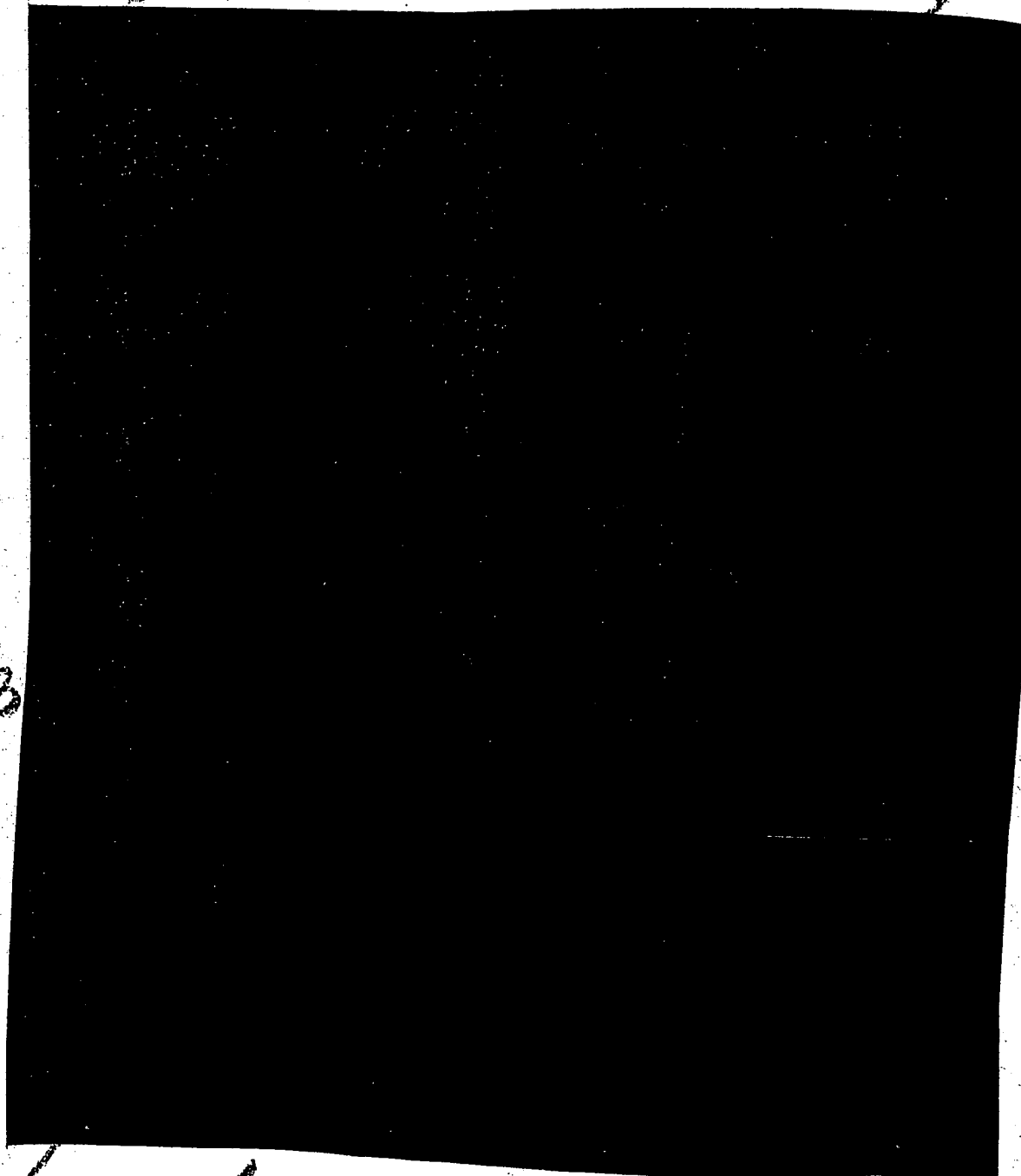
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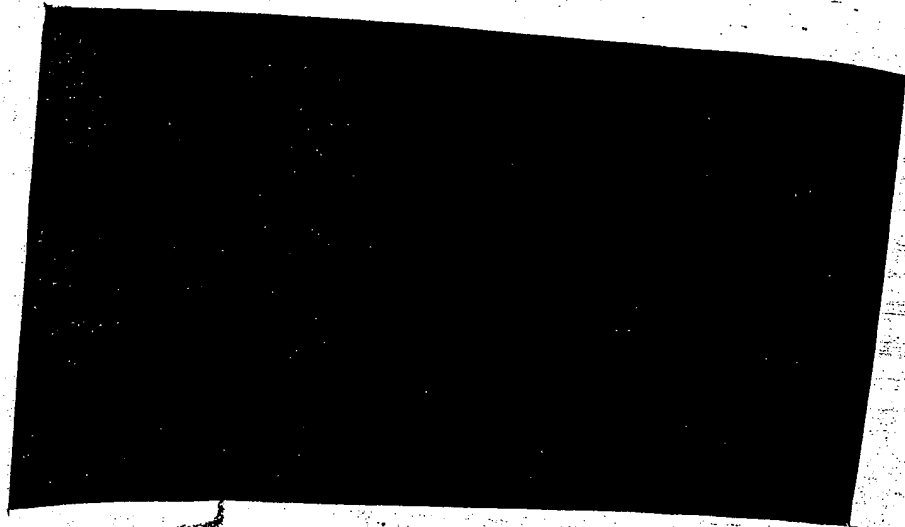
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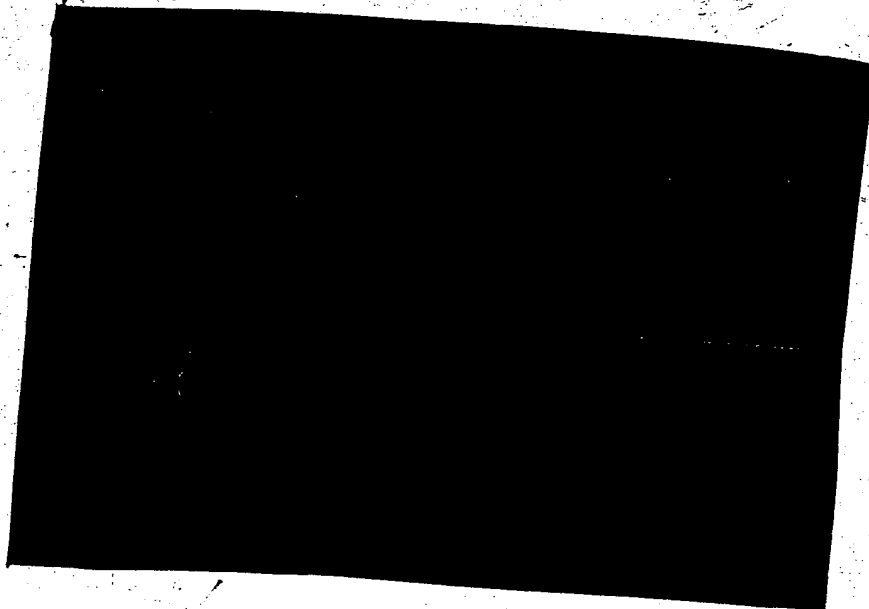
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FRANCE: Leftists Agree on Election Strategy

The Socialist and Communist Parties have formed an alliance for the municipal elections in March. [REDACTED] The Communists reportedly promised not to vote with the right to overturn the Socialist government during the term of the National Assembly. [REDACTED]

b3 [REDACTED] The agreement emphasizes the mutual dependence of the two leftist blocs. Despite speculation about Socialist-centrist cooperation, the Communists are a much more dependable partner for the Socialists. The Communists' support of public-sector strikes last fall and their failure to back a Socialist budget bill last month reminded the Socialists that the Communists are a force with which the government must reckon. The alliance probably will help the leftist parties—especially the Communists—retain some municipal power bases; the Communists' electoral fortunes have declined in recent national elections. The alliance will also diminish Socialist losses that the right might claim are evidence of public dissatisfaction with Prime Minister Rocard's government. [REDACTED]

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CUBA: Concern High About TV Marti

President Castro [REDACTED] has warned that he regards US plans to begin television broadcasts into Cuba as a serious provocation and that he intends to retaliate. Cuba's Justice Minister said earlier this month that TV Marti would put possible bilateral cooperation in other areas, including drug interdiction, in jeopardy. [REDACTED] indicate that Radio Marti, which began operations in 1985, has a large, diverse, and loyal following. [REDACTED]

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[REDACTED] Cuban leaders are particularly concerned because of Radio Marti's success, and their threats are intended to discourage US plans to begin television broadcasts. Havana probably also views the issue as a test of the new US administration's policy toward Cuba. Initially, Havana would be likely to jam the broadcasts—a step within its capabilities—and the Cubans might also seek to disrupt some medium wave radiobroadcasts in the US. Castro would be less inclined to suspend the bilateral emigration accord, as he did in response to the advent of Radio Marti, because the regime derives considerable benefit from that agreement. [REDACTED]

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INTERNATIONAL: Payments to IMF Lagging

Overdue payments to the IMF from member countries continue to mount. As of 1 December, total arrears to the IMF had reached a record \$3.5 billion, up \$1 billion from the level in 1987. Of the 20 countries overdue, 13 were delinquent by more than a month. Eight of them account for about 90 percent of the total overdue and have been declared ineligible by the IMF for additional loans—Guyana, Liberia, Peru, Sierra Leone, Somalia, Sudan, Vietnam, and Zambia. [REDACTED]

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[REDACTED] Delinquent payments to the IMF are becoming more frequent, and about half the approximately 125 countries that borrow from the Fund experienced some delay last year. If this situation continues, it will weaken the Fund's financial base and undermine its key role in the Third World debt strategy. [REDACTED]

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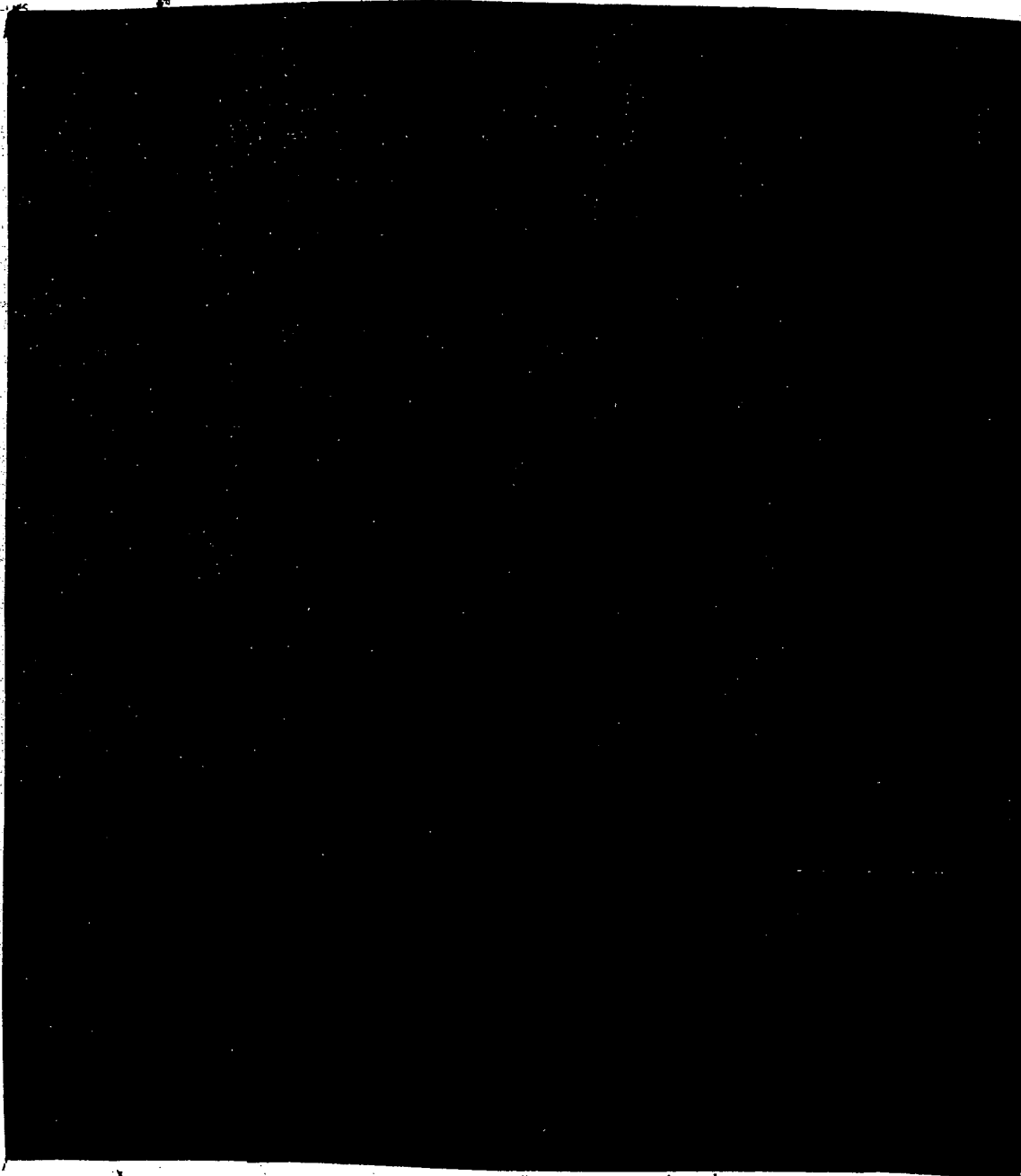
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In Brief

Middle East

- [REDACTED] b1 b3
- Arab League meeting in **Tunisia** dealt briefly with **Lebanon**, set up committee to contact Lebanese parties ... focused on Palestinian uprising in Israeli-held territory ... promised more money and strong international lobbying for Palestinians. [REDACTED] b3
 - Car bomb exploded yesterday in Beirut's southern suburbs during Hizballah-sponsored protest of intra-Shia fighting in **Lebanon** ... press says two Shia clerics among casualties ... fundamentalists probably will accuse Amal despite its disavowal. [REDACTED] b3

USSR

- Former General Staff Chief Akhromeyev today says he endorses announced unilateral **Soviet** troop cuts ... probably trying to scotch reports of his opposition ... also claims new defensive doctrine, troop cuts will allow reduction in defense spending. [REDACTED] b3
- Gorbachev told **Soviet** agriculture conference yesterday party meeting on agricultural reforms postponed from February to March ... comments by head of state agroindustrial committee indicate reorganization of agricultural bureaucracy likely [REDACTED] b3

East Asia

- Troops used to quell unrest at **China's** Daqing oilfield last month, [REDACTED] b(3) protests continuing over low wages, poor conditions ... first use of military against Chinese civilians in several years. [REDACTED] b3

Americas

- [REDACTED] Sandinistas approved march by **Nicaraguan** opposition tomorrow ... first major opposition rally permitted since July ... violence not expected, planning difficulties may limit size. [REDACTED] b3

Europe

- Prime Minister Thatcher has said measures being taken against **British** firms supplying equipment for **Libya's** Rabta complex ... lends support to US calls for cutoff of foreign involvement ... London reiterating desire for nonmilitary action. [REDACTED] b3
- [REDACTED] b1, b3

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Special Analysis

LEBANON-SYRIA:

Damascus and the Shia Civil War

The current round of clashes between Amal and Hizballah has not substantially altered the balance of power between the two Shia groups. Syria, which has links to both sides, does not yet appear willing to step in forcefully in Lebanon to end the fighting. Damascus may see the Shia unrest as increasing its leverage on both factions.

Since the first serious outbreak of fighting between Amal and the more radical Hizballah militia last April, there have been hundreds of deaths, including many civilians. The latest round of clashes in southern Lebanon alone reportedly has resulted in more than 100 deaths and 15,000 new refugees.

Amal has established itself as the primary Shia force in the coastal south; Hizballah has demonstrated superior strength in the southern suburbs of Beirut and in the Bekaa Valley, including its southern approaches near the Israeli-occupied security zone. Hizballah wants Amal to let it return to southern Lebanon, and Amal continues to demand that Hizballah hand over the assassins of several Amal leaders.

The months of fighting have weakened both groups.

Amal has lost several key leaders to the violence. Perhaps more worrisome to Amal is Syria's recently more evenhanded treatment of the two militias. That shift has severely undermined the myth that Amal enjoys ultimate protection and unquestioned assistance from Syria.

Syria's Role

Syria's efforts at mediation and its eventual intervention in Beirut's southern suburbs last spring to break up the Shia clashes there were only temporarily effective. Damascus has not exerted the kinds of pressure—physical harassment, interruption of supplies, threats—that it has used in the past to coerce Lebanese groups.

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Syria probably will avoid decisive intervention in the Shia struggle, realizing that, as the two militias exhaust themselves, their capacity to resist Damascus also decreases. Syrian strategy in Lebanon has long been to keep all factions relatively equal, according to the US Embassy in Beirut, and Damascus is not likely to allow either militia to win clear dominance over the other. [REDACTED]

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Hostage Implications

Increased Syrian influence over the Shia community in Lebanon is not likely to improve the situation of the Western hostages held by Hizballah. Although Damascus will continue seeking political benefits in the international community from its mediating role in the hostage-related dialogue, it is unlikely to press Hizballah hard on this issue. The fighting, meanwhile, poses a threat to the hostages' safety, as they may get caught in the crossfire. Various reports indicate that hostages have been moved during past Amal-Hizballah confrontations. [REDACTED]

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Concern About Economic Reforms Increasing

"Two years ago I would say: 'We will have success in *perestroyka* by the year 2000,' and everyone said: 'Abalkin? What a pessimist.' Now, I still say we will have success in *perestroyka* by the year 2000, and they say, 'What an optimist.'"

— Leonid Abalkin, Director, Institute of Economics of the USSR Academy of Sciences.

"... we still do not seem to have the decisiveness required for the most radical and crucial steps."

— Stanislav Shatalin, member of the USSR Academy of Sciences.

"We simply cannot possibly win the price [reform] campaign under the present conditions. No matter how carefully the retail price increase might be prepared and explained to the people, no matter how much compensation will be paid to the consumer, the ensuing situation would not satisfy the majority"

— Nikolay Shmelev, Institute of the USA and Canada.

"The absence of a normal market system ... distorts socialism, prompts speculation, and causes the emergence of mafia-type groups."

— Nikolay Petrakov, Deputy Director, Central Mathematics and Economics Institute of the USSR Academy of Sciences.

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Special Analysis

USSR:

Council of Ministers To Discuss Economic Reforms

The Soviet Council of Ministers today will address the slow progress of reform and other economic problems. Faced with growing popular restiveness, Moscow has backtracked on key economic reforms that would hurt the consumer and is relying primarily on resource reallocation to increase consumer output. General Secretary Gorbachev is apparently concerned that the short-term economic costs of pushing ahead too fast on economic reform would erode public support for perestroika. It is not too late for the leadership to reaffirm its commitment to economic reform in order to achieve many of its goals for the early 1990s, but time is running out.

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Economic reform was already hampered by flawed legislation and bureaucratic resistance, and Soviet officials admit that the reforms introduced last year produced no major breakthrough in economic performance. The reforms worsened the position of consumers as wage reform contributed to the inflation that is reflected in substantial price increases in farm markets and shortages in state stores. Because of the centrally administered price structure, many enterprises have used their new freedom to plan output to eliminate or reduce the production of unprofitable lower priced goods.

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Soviet officials are concerned about the growing impatience among consumers for welfare improvements from economic reform. Former Moscow party boss and candidate Politburo member Yel'tsin told an Italian newspaper this week that he and others believe the leadership has a year or perhaps two to improve the lot of consumers "before they rebel."

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Backtracking on Reforms

Moscow, faced with growing consumer concern, nationality tensions, and problems in implementing political reform, has backtracked on pending economic reforms that could spur inflation or negatively affect the consumer. The linchpin of the entire program, reform of wholesale prices, is scheduled to begin next year but reportedly will entail only a revision of prices rather than a more flexible pricing mechanism. Changes in agricultural procurement prices that were to be implemented by 1 January 1991 reportedly have been deferred, and retail price reform scheduled for the same year has been postponed indefinitely.

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Soviet Economic Reforms: Status Report

Reform	Status
Self-financing	On schedule, but has not resulted in genuine financial accountability because implemented before price reform.
Planning	State orders substantially reduced from 86 percent in 1988 to 40 percent in 1989; still high degree of central control.
Supply	Ahead of schedule, but criticized for not giving enterprises enough freedom to choose suppliers.
Wholesale prices	On schedule, except for agricultural procurement prices, but will entail price revisions rather than changes in the price formation mechanism.
Retail price reform	Originally scheduled for 1991, but postponed indefinitely.
Private sector	Spurred by law on cooperatives, but still accounts for only small fraction of total goods and services produced by state. Some activities were recently regulated or prohibited, but these measures affect few existing cooperatives.
Foreign trade	Original legislation recently liberalized but key restrictions remain.

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The leadership continues to support the development of independent cooperative businesses, many of which produce consumer goods and services. Soviet leaders have, however, approved measures that will restrict many of these businesses in setting prices because of popular resentment over price gouging. The leaders also plan to invest more in housing, food processing, and light industry this year. Moscow has tasked the defense industry to assume a greater role in the production of consumer goods. This year's plan calls for the defense industry to improve the quality and increase the production of consumer goods and capital equipment for consumer-related industries. [REDACTED]

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Prospects

Today's Council of Ministers session provides the leadership an opportunity to confront its problems with economic reform. Moscow may only be willing, for now, to push reforms that have little potential for disruptions, such as recent measures limiting the proportion of enterprise output determined by Gosplan, increasing enterprises' autonomy in conducting foreign trade, and allowing them to issue shares. [REDACTED]

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To make major gains during the early 1990s, however, the leadership must soon reaffirm its commitment to reforms in key areas like wholesale pricing and planning that are needed to make enterprises compete in search of profits. The chief of the Economics Institute, Leonid Abalkin, recently said, "There is still time to switch to the new form of planning and management today, but tomorrow will be too late." [REDACTED]

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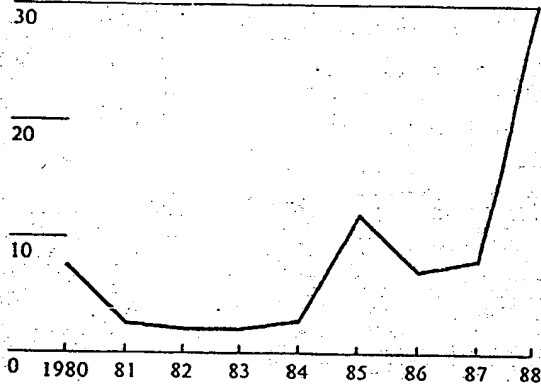
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China: Economic Indicators, 1980-88

Note scale changes

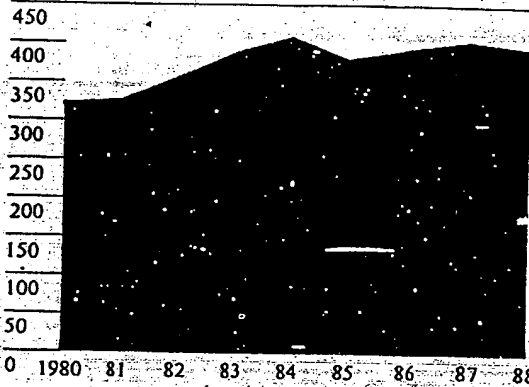
Urban Inflation Rate

Percent



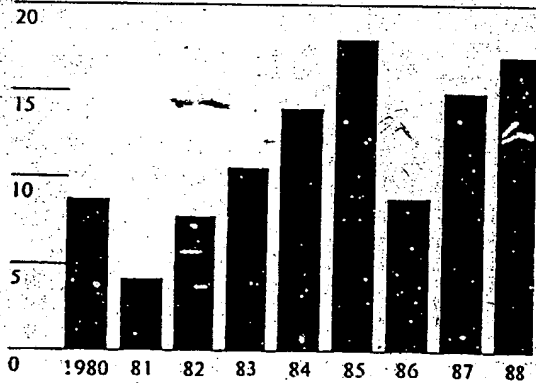
Grain Production

Million metric tons



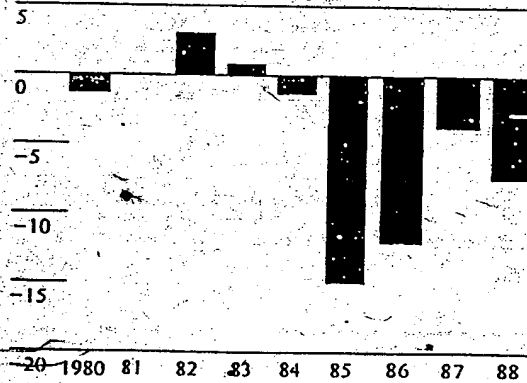
Industrial Output Growth

Percent



Trade Balance

Billion US \$



Note: Official Chinese statistics.
Data for 1988 are projected.

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Special Analysis

CHINA:

Losing the Battle Against Inflation

Retrenchment policies Beijing has adopted over the past five months are not likely to do much to reduce urban inflation in 1989 from its current level of more than 30 percent, the highest in nearly 40 years. Beijing will try to tighten enforcement of such measures as ceilings on nonproductive investment and spending for nonessential imports but will probably ease credit controls to keep enterprise earnings and tax revenues from dropping while increasing subsidies to urban workers hurt by inflation. The pursuit of such contradictory policies is likely to sharpen differences within the leadership and weaken further its ability to manage China's economic problems.

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Inflation and the related problems of an overheated industrial sector have led Beijing since August to take measures to curb consumer, investment, and government spending; limit exports of items in short supply; stimulate the production of scarce raw materials and agricultural goods; and slow growth in the money supply. These steps have not slowed the economy. Industrial production—up 18.8 percent in the fourth quarter over a year earlier—grew at a faster rate last month than in November. In an unusually gloomy speech last month, the Finance Minister announced new tax hikes and tighter budget controls to combat inflation. Meanwhile, Beijing has put off major price reforms for two years while leaders try to bring inflation down to single digits.

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Halfhearted Austerity Efforts

Concerns about the repercussions of some policies have led Beijing to avoid addressing some of the most serious causes of inflation—excess cash in the hands of consumers and out-of-control borrowing by state-owned factories. Beijing recognizes, for example, that feverish consumer spending is partly the result of rapid increases in wages and bonuses but has assured urban consumers that their salaries and government subsidies will increase with rises in food costs and rent. In what appears another move to mollify urban workers, Beijing recently announced plans to increase the production of consumer goods, overturning a decision announced in October to slash state investment for consumer goods factories. And, to protect state-owned enterprises and keep their large work forces employed, Beijing has ordered that they be given priority access to low-interest loans and raw materials.

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Beijing's failure to get the full cooperation of powerful provincial and municipal leaders has also dealt severe blows to the austerity program. Local officials often override loan denials and approve

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nonessential construction projects. China's weak central bank, moreover, is unable to control lending by the hundreds of new financial institutions that have sprung up in recent years.

Looking Ahead

Pressures to rescind tight money policies will probably force Beijing to ease controls this spring. China's leaders fear that a stringent, impartial enforcement of their austerity policies would risk cutting aggregate production as well as demand and might lead to the kind of low growth-high inflation that has taken place in Poland and Yugoslavia. They fear a drop in industrial production would cut state revenues at a time of rising expenditures. At the same time, Beijing has come under intense criticism from farmers for offering IOUs instead of cash for their fall harvests. It recognizes that the move will reduce incentives to grow grain and cut funds available for spring planting and that higher prices, fewer goods, and more widespread use of ration coupons for food and consumer products would add to urban discontent. Beijing thus will probably need to provide credits for enterprises to sign annual supply contracts and for peasants to buy seed and fertilizer.

Some of China's most profitable, internationally competitive enterprises like its rural textile and garment factories will probably see earnings decline sharply as Beijing gives priority for loans and raw materials to large urban facilities. As a result, China's trade deficit will widen, paralleling an increase in its domestic budget deficit as revenues decline and subsidy payments increase. Although both deficits will remain manageable, budgetary problems will keep Beijing from raising grain prices to the level needed to stimulate production.

Regardless of what Beijing does over the next few months, urban inflation will not dip much below 30 percent this year. The anticipated rollback of credit restrictions would funnel even more money into the economy and accelerate inflation. Even if controls remain in place and growth in the money supply slows in the second and third quarter, however, the infusion of funds in 1988 will keep inflation at about its current level for at least the next year.

_____ agrees that Beijing's efforts to cool the economy and slow inflation are not likely to be fully successful and anticipates wider budget and trade deficits in 1989. But _____ sees the positive effects of high real GNP growth as, on balance, outweighing the negative effects of the inflation it engenders. _____ believes, moreover, that the expected rise in the trade deficit will have beneficial effects as more goods will be available for domestic use. _____ also believes that additional steps, such as raising interest rates above the rate of inflation, can be taken if the economy fails to cool sufficiently.

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